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Spain and the end of European illusions

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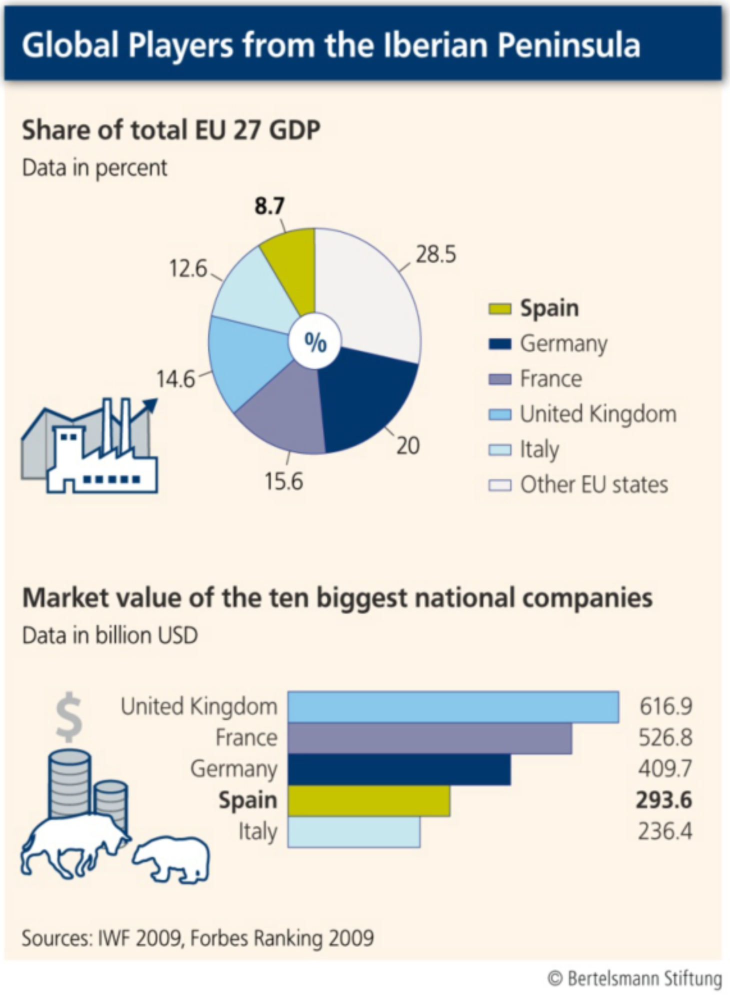
Spain was expecting its EU presidency of the EU Council to be a more pleasant experience. Looking back, these six months were totally dominated by the economic crisis, which put an abrupt end to a long boom period. The Spanish were baffled by the way that the actual problems were hyped up by the European media. One thing is certain: 25 years after it joined the European Community, the country faces major challenges – economical, political and social.

In a state ceremony held on 12 June 2010, Spain and Portugal celebrated the signing of the accession agreements to the European Economic Community 25 years ago. Accession to the European Economic Community was not only of symbolic importance to the two countries, which were still young democracies at the time. The political and economic balance sheet on membership has been very positive for both countries. And, conversely, it is also true that especially Spain has played an active role in European debates over the past decades, strengthening the process of integration in a positive way.

Nevertheless Spain is currently looking askance at Europe and Europe at Spain. The celebrations on 12 June are also symbolic here: the Spanish and Portuguese celebrated by themselves. Solely the President of the European Parliament, Jerzy Buzek, undertook the journey to Lisbon – otherwise nobody came from Brussels, Berlin, Paris or London. What is worse – the other European countries did not even notice this historical date. Instead, the European media – with the German media leading the way – indulged in crisis scenarios: the government in Madrid was said to be on the brink of bankruptcy and would have to make use of the rescue package for ailing Euro states in the near future.

For the media it makes sense to cover Spain together with Greece and other “southern European states”, thus creating a self-fulfilling prophecy in the current situation: the hysteria of the markets is whipped up anew with every new report in the media and, along with it, the costs of refinancing the government deficit as well as mistrust in the banks of the respective country. Nor does there appear to be room for anything else: the Spanish Presidency of the EU Council, which ended in June, has been long forgotten as a topic of debate outside Spain.

There is no question that Spain is in a deep economic and political crisis. The crisis is not a purely Spanish one, however. It also exposes a flaw in the process of European integration and threatens relations between Spain and Europe. A farewell to illusions and energetic reforms are the order of the day – but not only in Spain.



I

The first illusion: coherence is not a "freebie"

One of the core ideas underlying European integration is still to approximate economic power and thus living conditions in the member states as well. The illusion that this heterogeneity would evaporate with the common market and the common currency has been shattered by the example of Spain.

The Spanish economic boom was a boom on credit. Compared to the rest of Europe, the interest rates of the European Central Bank were too low for the uncompetitive economy of the country, which was oriented towards the domestic market. Its accession to the Monetary Union unleashed a boom in consumption and the building industry unlike the country or the continent had ever seen before. In some years up until 2007 more residential units were built in Spain than in Germany, France and Italy put together. The high rate of migration to Spain – according to unofficial estimates around 5 million persons have immigrated into Spain since 1999 – and the wave of northern and central Europeans purchasing second dwellings on the Spanish coast only explain this development in part. The fact of the matter is that many Spaniards and institutional investors allowed themselves to be enticed into speculating in real estate as a result of low interest rates and rising real estate prices. Financing packages offered by local savings and loans made it attractive to purchase real estate for people with low income as well.

Growth rates averaging 3% made Spain one of the most attractive countries in the EU for investors. Prosperity grew perceptively and export-oriented European partners – with Germany at the top of the list – rejoiced over what seemed to be a never-ending upward spiral in exports to Spain. The dangers of this growth on credit either were not seen or they were played down.

The real estate bubble burst with the onset of the international financial crisis. The building sector, which in 2007 still contributed 7% of Gross Domestic Product (GDP), collapsed. Real estate prices have been plummeting ever since, while unemployment is soaring to record levels: in the second quarter of 2010 the unemployment rate hit 20%. Among young adults it has even reached 40%. Half of all jobs in the building sector have been eliminated. As a result of the high unemployment, consumption has also taken a nosedive, dropping 6% in 2009 alone.

Since then Spain has been mired in a recession. A 0.4% decline in GDP is being forecasted for 2010 as well. Spain is only expected to grow moderately again in 2011 – the last big national economy in the Euro zone to return to the growth path. For the government budget, this means dwindling tax revenue and considerably greater outlays. The government took in 15% less tax revenue in 2009 than in the previous year. In addition to expenditures on unemployment benefits, increased government spending was also channelled into the economic stimulus package, as almost all European countries did in 2008 and 2009 in order to prevent a complete economic meltdown. As a result, the Spanish budget deficit jumped from 4.1% of GDP in 2008 to 11.2% in 2009.

Spain has benefited from the fact that all its governments kept a tight lid on budgets until the outbreak of the crisis. During the growth years budget surpluses of up to 2% of GDP were registered. Politicians resisted the temptation to bloat the state apparatus. The percentage of economic output accounted for by the state was reduced to 39% in 2007, which is low

Spanish European Policy since 1986

December 1982 – May 1996

Prime Minister Felipe González (PSOE)

- **January 1986**
  Spain joins the European Community
- **February 1988**
  The reformed European Structural Funds grant billions of euros to assist Spain's economically weak regions
- **January – June 1989**
  Spain assumes the EC presidency for the first time
- **May 1994**
  Spain becomes the greatest beneficiary of the newly-established Cohesion Fund
- **July – December 1995**
  Spain holds its second EU presidency
- **November 1995**
  The Euro-Mediterranean Partnership (also known as the Barcelona Process) is founded at the behest of the Spanish EU presidency

May 1996 – April 2004

Prime Minister José María Aznar (PP)

- **January 1999**
  Spain adopts the euro as a founding member of the Economic and Monetary Union
- **January – June 2002**
  The fight against terrorism is the major issue of the third Spanish EU presidency
- **January 2003**
  Aznar and seven other EU heads of state and government declare their solidarity with the US in the run-up to the Iraq war and thus split the EU
- **November 2003**
  Aznar calls for sanctions against Germany and France on account of their non-compliance with the Stability Pact
- **December 2003**
  Spain and Poland veto the Constitutional Treaty due to their opposition to double majority voting

Since April 2004

Prime Minister José Luis Rodríguez Zapatero (PSOE)

- **June 2004**
  Spain ends its obstruction and the EU heads of state and government reach agreement on the Constitutional Treaty
- **February 2005**
  At the consultative referendum 77 percent of the Spanish electorate vote for the Constitutional Treaty
- **December 2005**
  At the negotiations on the EU 2007-2013 financial framework Spain defends its status as net recipient and further grants from the Structural and Cohesion Funds
- **July 2008**
  The Senate and Congress of Deputies ratify the Treaty of Lisbon
- **January – June 2010**
  Spain is the first member state to hold the EU presidency after the entry into force of the Treaty of Lisbon

by European comparison (Germany 43%, France 52%). This explains why the debt-to-economic-power ratio, which was 53% even in 2010, is still below the EU average and far below that of Germany (73%) or France (78%).
Another bright spot in the Spanish economy often goes unmentioned in the current debate. Strong multinational enterprises have been established in Spain. Forbes magazine ranks three Spanish enterprises (and two German ones) among the 40 biggest global players. The big Spanish banks Santander and BBVA and the formerly state-owned telecommunications company Telefónica have left the European competition far behind and ensure that Spain will participate in the recovery of the world economy. They are especially active in the growth markets of Latin America.

Thanks to the Spanish financial supervisory authorities, which prohibited speculation with American bonds and forced banks to make high anti-cyclical provisions during the boom, the major Spanish private banks have made it through the financial crisis in far better shape than their European competitors.

The picture looks different with the more than fifty savings and loan banks which are suffering from burgeoning write-downs on domestic real estate loans. The central bank has already forced the first savings and loans to merge. In contrast to Germany, it has not been necessary to use the rescue-package millions to date. Articles in the German press stating that the Spanish banking industry was on the verge of collapse have turned out to be groundless, but nevertheless managed to have a pernicious effect on the issue of Spanish treasury bonds in the middle of June. Not only the government in Madrid and the European Commission but also members of the German government expressly stated that the reports were false. In order to restore confidence in the stability of the Spanish banking system, the Spanish government prevailed in its efforts to have stress tests on European banks published in the future at the final summit in its presidency of the EU Council on 17 June.

II

Reform: between saving and growth

The economic boom in countries like Spain and Ireland, which went hand in hand with the monetary union, gave rise to the hope that the economic differences within the Euro zone would fade away on their own. At the end of the boom, the differences in

Spain's sore spot: Economy and finances

Uncertain economic recovery
In the wake of the economic crisis Spain is recovering more slowly than other EU member states. After the dramatic slump of **3.7 percent** in 2009, the economy has continued to contract by **0.8 percent** this year. Spain will not return to growth before 2011 (**+1 percent**).

Soaring Unemployment
Since 2007 the unemployment rate has virtually doubled, rising from 8.3 to almost **18 percent** (with a total of 4.3 million unemployed). This means that Spain has the worst record of any country in Europe. Youth unemployment has reached about **40 percent.**

Rising Public Debt
Until the outbreak of the economic crisis public debt amounted to **36 percent** of GDP (2007) which was significantly below the Maastricht limit. By 2009 the debt ratio had risen to **54 percent.** A reversal of this trend is not in sight and the debt ratio may well rise to **74 percent** by 2011.

Soaring Deficits
Spain missed the 3 percent deficit target in 2008 and 2009 after three years with budget surpluses. Missing tax revenues, higher social expenditure and measures designed to stimulate the economy have lifted new debt levels to **11 percent** of GDP.

Source: European Commission

the macro economies of the Euro zone appear more pronounced than ever. Ailing macro economies are more vulnerable than before. Painful reforms to the Spanish economic model are just as necessary as is a fundamental overhaul of the European Economic and Monetary Union.

In terms of economic and regulatory policy, Spain is being forced into a balancing act: on the one hand the government deficit has to be radically reduced. The goal stated by the government of José Luis Rodríguez Zapatero is to cut the budget deficit to 3% and thus return to the level set out in the Stability and Growth Pact. Already in January 2010 the Socialist government submitted an austerity programme containing EUR 50 billion in cut-backs. An additional austerity programme was added to this in May, providing for another EUR 15 billion in belt-tightening measures. The European Commission and the International Monetary Fund have voiced their support for the strategy.

It is as yet unclear, however, how new growth is to come about. The weak links in the Spanish economy continue to be its low levels of productivity and competitiveness. The Spanish labour market is ailing under a two-fold problem: an inflexible section made up of workers with long-term employment contracts, who it is practically impossible to make redundant, and a virtually unregulated sector in which employees have to grope from one temporary contract to the next.

Following fruitless negotiations with social partners in the middle of June, the Socialist government has submitted a draft bill aimed at reforming the labour market. Whether the minority government will be successful in pushing the law through Parliament or not is uncertain. The conservative People's Party is not budging from its obstructionist attitude. The small party of Catalan Christian Democrats could help the government obtain the needed majority, as was already the case with the small package of austerity measures adopted in May.

But there is more at stake than just a reform of the labour market. Spain has to generate growth in completely new sectors. Education and research are the top priorities here. The Spanish educational system has been suffering from sluggish progress in reforms for some time now. 30% of all young people drop out of school prematurely. The OECD's PISA studies show that the Spanish school system is inefficient compared to other European countries. Vocational education has also been neglected. Investment in research and development continues to lag behind the European average. The Spanish government needs to do no less than reinvent the entire national growth model.

But Europe must also bid farewell to the illusion that coherence can be obtained for free. A common currency and central bank alone are too weak to reduce the heterogeneity of national economies. On the contrary: Spain and Ireland show that asymmetrical shocks even exacerbate differences in development. The first steps taken in the direction of a tighter coordination of economic policy, as were decided by the heads of government on June 17, point in the right direction. Whether these will suffice to put different national economies on a common, sustainable growth footing remains to be seen. If the task at hand is to limit the development of dangerous long-term imbalances in competitiveness and current accounts, then there must be no taboos in the future.

III

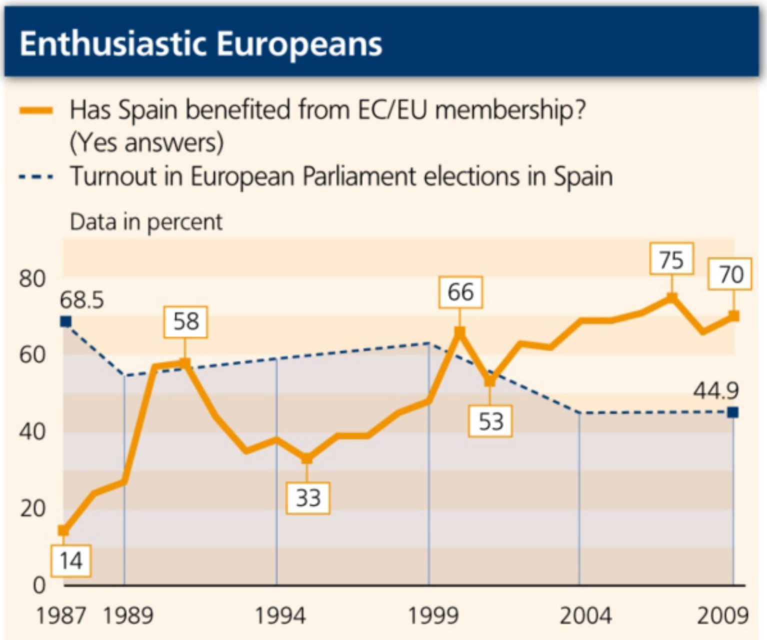
The second illusion: democracy means confrontation

The Spanish democracy has proven to be extremely durable in its thirty years' history. Spanish society has surmounted major challenges with relative ease, exhibiting a remarkable openness to change – from separatist terrorism to the Islamic attacks in 2004 all the way to the dizzying transformation from a country with a net emigration balance to one with a net immigration balance.

These fundamental characteristics appear to be leading Spanish society through the current crisis as well. Thus far, neither the ever more tangible effects of the crisis nor the reform efforts of the government have unleashed spasms of outrage and violence like in Greece. The social partners are sticking to familiar forms of politics. There is no trace of hysteria. An initial strike called by public workers against the government's second package of austerity measures only met with luke-warm support from the rank and file. The trade unions are only planning to cross swords with the Socialist government in September, when it is due to submit the budget for 2011 to the Parliament.

But current results of surveys give rise for concern over the state of democracy in Spain. The stable two-party system – which is only fragmented on the edges by nationalist parties from the Basque country, Catalonia and other regions – has revealed a defect in the crisis whose long-term impact cannot be predicted. For decades now the two leading parties, the Socialist PSOE and the conservative People's Party (PP), have been locked in a debate of mutual negation, with both sides lacking any inclination whatsoever to seek compromise. The parties are not aware of any other political mode than absolute confrontation. Instead of looking for common ground in the crisis, the verbal trenches between the governing Socialists and the Conservative opposition have only grown deeper over the past months.

The austerity and reform proposals forwarded by the leader of the opposition, Mariano Rajoy, are along the same lines as those of the government. This makes his criticism of government, recited over and over like a mantra, all the more incomprehensible. A large part of the criticism has to do with electoral tactics.



Sources: Eurobarometer, European Parliament

The PP hopes that the Zapatero government, which does not have a stabile majority in Parliament, will fall by autumn at the latest in its bid to force through the new budget, thus making new elections unavoidable. It is highly likely that this would then lead to a change in government. According to surveys, the People's Party is currently in front of the governing PSOE.

At the same time, this obstructionism is irresponsible. It limits the latitude for action on the part of the government to an unwarranted degree, forcing it to provide small regionally-based partners a say in weighty issues which the future of the country depends upon.

The tolerance of voters for the heated party dispute has declined considerably: in a survey carried out for the daily El Pais in June, 88% of persons surveyed stated "yes" in response to the question "Should the PSOE and PP attempt to come up with a compromise pact transcending party lines instead of bashing each other?". The crisis of confidence in the political elite is dramatic. 86% of persons surveyed state that they have little or no confidence in Mr. Zapatero, the head of government. 73% do not believe that Rajoy would do any better, and 77% are of the opinion that in general Spain needs different politicians to head the parties. The overwhelming majority do not want new elections. In the May survey of Centro de Investigaciones Sociológicas 19% of those surveyed stated that one of the main problems in the country is the parties and their leadership.

The figures demonstrate that the Spanish political leadership would be well advised to close ranks in the crisis. This does not have to go so far as the formation of a formal coalition (although Socialists and Conservatives in the Basque country show that they are also capable of this). But clinging to conventional patterns of confrontational politics is harmful. It narrows the latitude for action for the entire country. Increasing disenchantment with democracy would be fatal, and this not only in the current crisis situation. Disillusion with politics and a loss of confidence would strengthen the nationalists in the regions – with unpredictable outcomes.

IV

The third illusion: Europe always feels good

Originally, the presidency of the Council was supposed to be the culmination of the foreign policy of Prime Minister Zapatero and his social reform team. The objectives formulated by the government were majestic and the summits were to be supposed to be accompanied by major fanfare in this traditionally pro-European country. Critics began questioning the government early on, however, saying that the list of priorities was nothing more than a smorgasbord of wishes and desires of various ministries, reflecting a lack of any real ideas for the future of the integration project.

But things turned out differently than planned. It only became evident late in the day that the Spanish presidency of the Council would be the first one to have to deal with the new set of rules contained in the Lisbon Treaty and that it still needed to define its own role located somewhere between the new office of the permanent President of the European Council and the new High Representative for Foreign Affairs and Security Policy. The new team was finally set in February 2010.

The major strategic lines which the rotating presidencies of the Council in the past were able to use as orientation were no longer available to the Spanish government and its experienced diplomats. After initial attempts to create a real impetus, the Spanish government had to content itself with performing the enormous but almost invisible and thus politically thankless administrative work. Foreign Minister Moratinos achieved several diplomatic highlights working behind the scenes, such as a compromise in the conflict between Switzerland and Libya or further relaxation of the situation in the Balkans thanks to Spain's good relations with Serbia. Various barriers along the path to the establishment of the European Foreign Service were also surmounted. The economic programme Europe 2020 was adopted surprisingly swiftly under the Spanish aegis.

In other areas there were unexpected setbacks: two planned summits were cancelled at the start: one with the U.S. and one with the Mediterranean countries. President Obama could not be convinced of the benefits of a bilateral summit. The meeting with the Mediterranean countries was doomed to failure right from the start as a result of tensions in the Middle East. The secretariat of the Union of the Mediterranean nevertheless commenced its work in March. Additional meetings such as the EU-Latin America summit ended with only a few tangible results.

It was not solely the Treaty of Lisbon which made the Spanish presidency of the Council of secondary importance. Spain had to endure another painful experience. Caught up in the midst of its own economic crisis, Spain was subjected to excessive criticism by partners, with its leadership being questioned. The press and political arena especially in Germany lavished ridicule on Spain. The political room for manoeuvre contracted even more as a result. Thus, for instance, the proposal of Zapatero to also consider sanctions within the framework of a more strongly coordinated EU economic policy right at the outset of the Spanish presidency was dismissed with scarcely concealed derision.

The fact that merely a few months later critics were calling for stronger sanctions and the European Council was officially mentioning such may constitute a quiet victory for the Spanish government. On the other hand, the major contours have been outlined in Berlin and Paris, not in Madrid. Thus Spain is emerging from its fourth presidency having learned that Europe can hurt as well. What Spain will do as a result of this experience cannot be foreseen as of yet. The feeling that it has been labelled as a loser and is as a result being excluded from the core of the decision-making process could well continue to grow, however. If that were the case, this country, characterised by so much euphoria over Europe in the past, may opt for a different course. This would not benefit Spain or the EU, however.

For Further Reading:

Friedrich Ebert Stiftung: Euroland Put to the Test. Can European Monetary Union Still Be Saved?, May 2010

Ignacio Molina: 25 años después del Tratado de Adhesión: España ya no es un problema pero Europa sí sigue siendo la solución, ARI 95/2010, Real Instituto Elcano, 11 June 2010

José Ignacio Torreblanca: La política exterior precisa de un replanteamiento por encima y más allá de Europa, presidencia en la sombra, 9 June 2010

Responsible

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